VISIT…

- Looking for 'headfakes', reversals & pivot points, recognizing net buying vs. selling

Main Points:

In this lesson you will learn how to spot 3 key market maker (mm) trading actions to help your Level 2 daytrading become more effective. They include:

- HEADFAKES: MM initially buying to make the stock look attractive as he gets short in the position, then selling the stock down, covering at bottom. "Gap and trap" is an example. You buy what looks to be a good stock, then the price drops abruptly, you sell in a panic and then it goes back up.
- REVERSALS & PIVOT POINTS: When the current trend (either buying or selling) reverses itself....eg. sellers are done and buyers come into play, or buying finished and selling starts.
- NET BUYING vs SELLING: Using the "number of times at best" feature and visually watching Level 2 action for major market makers to identify who is actually buying vs. selling (and how to tell when they are masking thier intentions).

Let's look at how each of these works, and how to profit from it:

Examples:

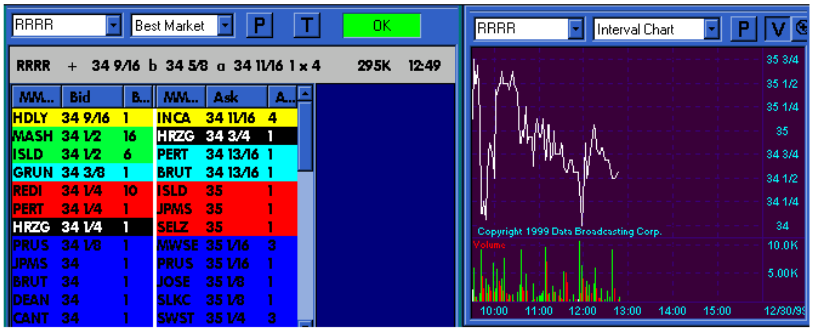
Examples:

Headfakes:

Some of the medium-sized market makers like HRZG SLKC etc. are more prone to playing games than are other market makers. The larger market makers tend not to play games with bid/ask sizes.

Looking at RRRR here, you can see on the one-minute chart that the stock was bid up starting at 10am. Traders who bought this "second top" were in for a surprise as HRZG sold it off down to the low of day at 34. What's the stock's trading range? 34 to 35 3/4.

What else would you look for to identify headfakes? The best advice I can give is to closely follow 3-5 stocks on Level 2 for a month or so each day and get to know the behavior of the different market makers and ECN players on the stock. You'll soon learn who the real players are. Remember, to



Daytrader's Play: Buy off the low-of-day 2nd bottom and short/sell at the second top, unless there's a breakthrough in either direction. Do not buy the second top of the day unless it's broken through (in this case I wouldn't have been a buyer until it broke through 36 on decent volume). Buying the second or third bottom off support (in this case 34) would be a good play. Don't buy when it's choppy within the trading range, you will get shaken out. Pay close attention to the volume and other TA indicators to confirm entries and exit points.

Avoiding Headfakes: The steeper the price increase, the more likely a reversal as traders who bought in low sell the stock for a profit. Avoid buying stocks that have run up in a vertical line until there's some kind of consolidation (sideways

succeed in daytrading takes a lot of patience and concentration, using the tools like the professionals do. It amazes me to see the losing gambling behavior of people in many of the chatrooms who are clueless as to how to trade stocks. Poeple like me and other professionals scoop their capital off the table with ease.

trading holding in a pattern for 10-15 minutes), then a continuation of an uptrend.

Especially avoid chatroom under-$10 stocks that run up on thin (less than 300K daily shares) trading volume.

On Level 2, watch for: fake volume sizes by mm's (eg HRZG posting 88 bid then fading), flipping back and forth from inside bid to ask, and mm's fading back a spread at a time even when time and sales looks bullish. These are warning signs that a reversal is about to occur.

REVERSALS & PIVOT POINTS:

These are my favorite plays, buying the bottoms and knowing when to sell at the top.

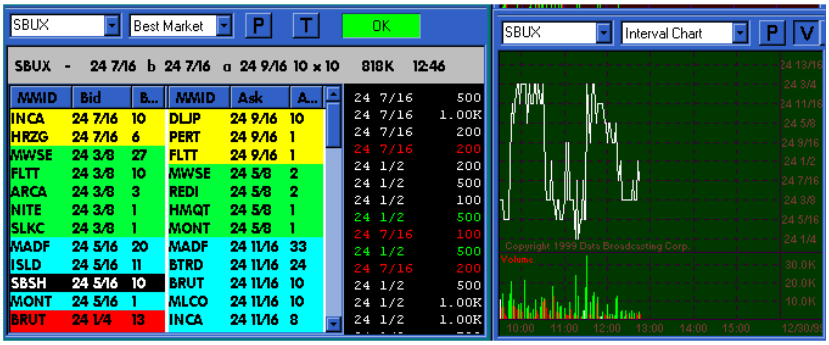
Looking at the intraday chart for SBUX here on 12/30, where is support and resistance? Can you see? Support at 24 1/4 and resistance at 24 3/4. A **profitable trading channel** to play in.

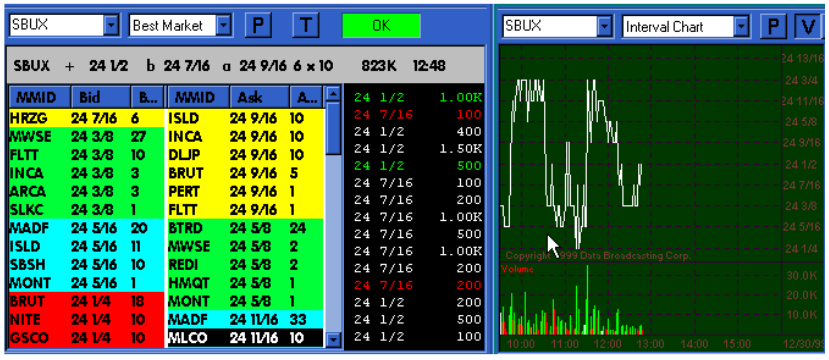
How does level 2 help you with this?

See how I've highlighted SBSH at 24 5/16 bid? Solly knows support is at 1/4 an d will buy stock here, unless the market sells off (in which case he'll lift his bid). But, SBUX is a slow moving stock, he waits for it to come down to his level to buy it.

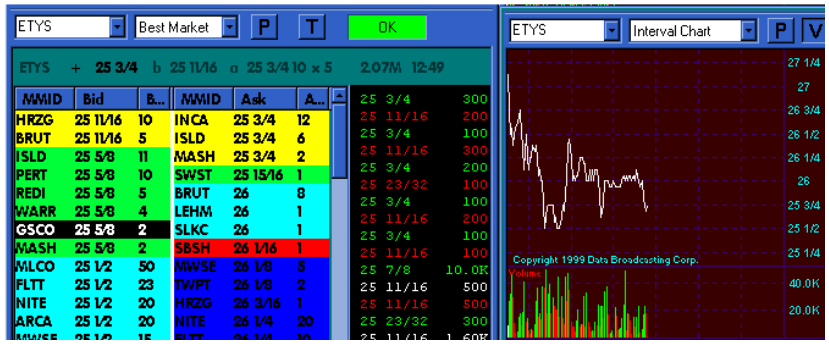
Now see in the second chart how I've highlighted MLCO at 24 11/16? He knows this is the initial resistance level, and has parked hit sell tier order here.

Knowing how these two trading desks trade SBUX is very profitable. Join the ISLD bid at 24 5/16 then offer it out at 24 11/16 or 3/4 for a nice profit.





Now let's look at ETYS, a current favorite for bottom-fishing (as of 12/30/99). Where is support and resistance? Well, we can see support at 25 1/2, and I highlighted GSCO as the ax to follow with a thin size 2 bid at 25 5/8. I would place a stop loss in at 25 3/8, as I see MLCO at 25 1/2 bid, and the stock has make 3 reversals at around 25 1/2. It's making lower highs, though, so I'd only play it for a scalp, joining the 25 5/8 ISLD bid here.



Daytrader's Play: Reversals on higher volume and second bottoms/tops are key places to look for pivots and reversals. Knowing to follow the ax particularly at the places he puts his bids and asks will help you get better at determining likely pivot points and reversals. As always, use tight stops (under 3/8) to minimize losses if you're wrong. If the stock wiggles and heads in the direction you originally thought it would you can re-enter the position with a small lost trade potential (1/8 max loss potential).

General level 2 reminder notes: watching time and sales as well as volume and overall market direction is important. Remember not to trade during lunch in general (11:30-1:30 or so), and know your stock's intraday market maker ax and support/resistance levels.

NET BUYING vs. SELLING:

Talk about a run! Look at NOVL here on 12/30 going from 35 to 40 in the space of an hour. SBSH is the ax for NOVL and was on the inside bid all morning (a bullish sign). Joining him at 35 1/2 and selling at the second shake near 38 is profitable.

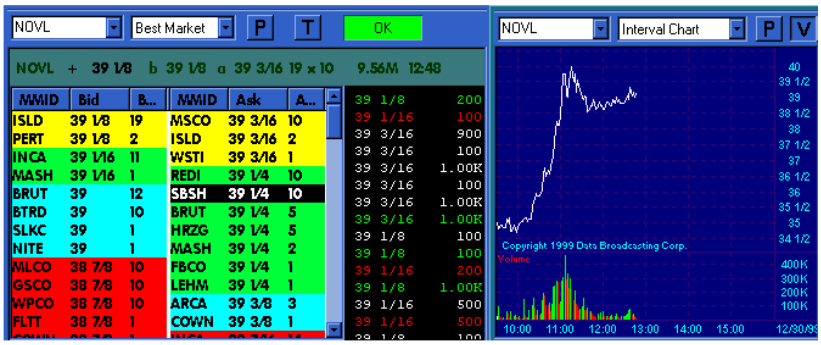
Now that he's on the second inside ask, I'd be more cautious about buying and would look to short the stock where he is offering to sell it at (offer it out at 39 3/16 stop market buy/cover at 39 3/8).

Recognizing net buying vs selling is a tricky business; some software identifies the "number of times at best" bid/ask for the trader; however this doesn't tell you the number of shares that were traded, number of refreshes and size/order flow information.

The best way to spot net selling vs buying is to see the length of time the market maker stays at the inside bid/ask (eg if MSCO stays here selling at 39 3/16, and the stock ticks down to 39 x 39 1/8 and he still stays at 39 1/8 selling, you'd call him a net seller). This depends you'd call him a net seller). This depends on the volume of order flow being sold, of course, I'd expect a mm to sell at least 8-15K shares to call him the 'ax' in a stock that trades more than 500K shares/day.

Note: Market makers will frequently lift off the inside bid/ask to mask their order flow, so keep an eye on their behavior in the green (1st outside level) band as well. On the whole, are they buying or selling, and have you identified the "biggest player(s)" in the stock at the time you are watching? Remember, the 'ax' will change, especially for the most actively traded stocks.

Also, be sure to know the difference between ECNs (INCA ATTN ISLD ARCA) and market makers (SBSH MLCO MSCO GSCO).



Daytrader's Play: Once you spot net buying by the market maker you are following, join his bid and stay with it until he flips. When SBSH flipped to the ask you know it's time to sell this stock, as he has bid it up all morning and wants to lock in his profit at the current price level.

Also be cautious of thin volume, eg here at 12:48pm it's the middle of lunch hour and you can expect some selling down to a fibo retracement level. In general, you should exit your morning positions before lunch (or put in a trailing stop) to lock in your profit. Notice how volume has thinned considerably from the morning runup period.

Looking at this level 2 chart, you also see sellers include heavyweights MSCO and SBSH, and the green outside ask band is thicker than the green outside bid band. This is bearish. Buyers are on thin levels and are mainly ecn players on ISLD/INCA. I'd sell it here and wait to buy on a breakout through the high of day at 40 1/4 or so.